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## **Banking system of Ukraine: problems and perspectives of development**

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**BANKING SYSTEM OF UKRAINE: PROBLEMS AND PROSPECTS OF DEVELOPMENT****Lyuta O., Ph.D. in economics  
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В статті здійснено аналіз розвитку вітчизняної банківської системи за період з 2005 по 2010 роки. Визначені основні проблеми, що перешкоджають успішному функціонуванню банківської системи України на сьогоднішній день. Запропоновані напрями удосконалення діяльності банківських установ в Україні.

**Ключові слова:** банки, банківська система, кредити, депозити, активи банку, зобов'язання банку

The development of the Ukrainian banking system from 2005 to 2010 is analyzed in the article. The authors determined basic problems and perspectives of the banking system functioning.

**Key words:** banks, banking, loans, deposits, assets, liabilities of the bank.

**Urgency of the problem.** In the modern situation of national economy development the condition of banking system is crucial. Obviously banks are one of the main sources of financial resources investment in the economy of the country.

Strong banking system is a necessary condition of a stable and balanced development of Ukrainian economy and its integration in the world economy. In the situation of low development of stock market and nonbanking financial institutions banking system of Ukraine is the largest official financial intermediary that meets the needs of the real sectors of economy and individuals in resources. With the development of international relations and increasing of globalization a lot of problems appear in the banking sector. These problems should be resolved immediately to ensure stability and normal functioning of the national economy. Due to rapid development of financial globalization process the banking system is confronted with more and more tasks, in the case of solution of which Ukraine will become an active participant in globalization processes.

**Analysis of recent researches and publications.** Considerable contribution

into the study of problem of banking system functioning were made by the following scientists: Galchinsky A., Burakovsky I., Heyets V., Moroz A., Romanyshyn V., Tyhipko S. The contribution of Ukrainian scientists in the solving of problems of banking system development is very important, but it is necessary to pay attention to the objective importance for further analysis and identifying of key directions of banks stabilizing.

**Purpose of the research.** Taking into account the results of banking system development during the period of 2005-2010 years, it is necessary to identify the main problems that prevent the successful functioning of the banking system of Ukraine at the present stage of economic development and substantiate ways for banking institutions improvement in Ukraine.

**Results' presentment.** Analyzing the peculiarities of national banking system development during the period from 2005 till 2010, we can summarize the positive quantitative and qualitative changes on the whole (Table 1).

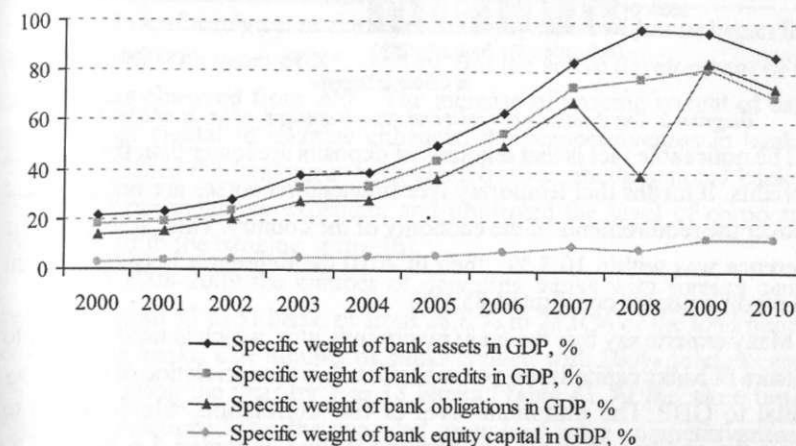
*Table 1. The main indexes of banking system development of Ukraine during the period from 2005 till 2010 (on the information of the National bank of Ukraine) [5]*

Indexes	2005	2006	2007	2008	2009	2010
Quantity of registered banks	186	193	198	198	197	194
Gross assets, bln.UAH	223,0	353,1	619,0	973,3	880,3	942,1
Credit portfolio, bln. UAH	156,4	269,7	485,5	792,4	747,3	755,0
Specific weight of credit portfolio in assets, %	70	76	78	81	85	80
Equity capital of banks, bln.UAH	25,4	42,6	69,6	119,3	115,1	137,7
Obligations of banks, bln.UAH	188,4	297,6	529,8	806,8	765,1	804,4
Net profit, bln.UAH	2,2	4,1	6,6	7,3	-38,4	-13,0

The quantity of banks was not essentially changing during analyzed period, besides the amount of total assets grew substantial, in more than 4 times. Eventually the banking system is considered exceptionally as the credit oriented as far as during the analyzed period the amount of credit portfolio constantly extended and its specific weight increased from 70 % in 2005 to 80 % in 2010. During analyzed period the obligations considerably grew, in more than 4 times. At the same time banks also increased the amount of

equity capital.

The key indexes of banking system development of the country, which in some way characterize its competitiveness in the global financial system, are the correlation of main indexes of banking system activity with the amount of the gross domestic product (diagram 1) [5]. During the period from 2000 to 2007 the banking system of Ukraine demonstrated the stable growth practically in all indexes.



*Diagram 1. The dynamics of specific weight of main indexes of banks activity in GDP during 2000-2008 (according to the National Bank of Ukraine)*

The global financial crisis had a major impact on the banking system of Ukraine, in particular it was a significant reduction in the share of banks assets to GDP. Taking into account the indexes mentioned above, in particular the specific weight of credit portfolio in total assets, their reduction had negative consequences for the economy development of the country on the whole. The specific weight of bank credits in gross domestic product abruptly declined, other indexes also reduced.

During 2005 – 2008 the dynamics of credit and deposit amounts were essentially increasing (Diagram 2). According to Deutsche Bank Research in 2007, Ukraine was in the group of the leaders in Central and Eastern Europe according to the growth rate of bank loans [4]. However, due to financial crisis in 2009, their volumes have significantly declined in comparing with 2008. It should be mentioned that in 2010 situation slightly improved. On the diagram

2 we can see the increase of volume of deposits. Growth of deposits, gives reason to say that the situation in banking sector has tendency to stabilization.

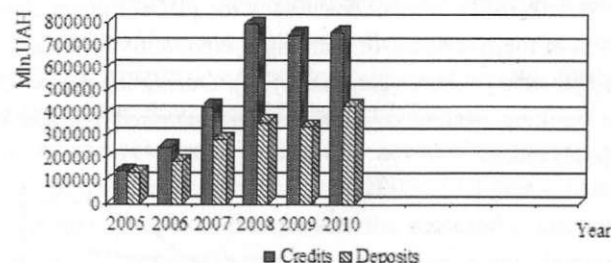


Diagram 2. The dynamics of credit and deposit amounts of banks of Ukraine

The noticeable fact is that amounts of deposits are lower than the amounts of credits. It means that temporary free financial recourses are not sufficient to cover the requirements of the economy of the country. Thus, if in 2005 this deference was within 10,3 %, then in 2010 the deference between deposit and credit amounts constituted 43,1 %.

Many experts say that the main macro indicator, which is used in order to measure of banks capitalization on macro level, is the correlation of regulatory capital to GDP. The minimum level of this correlation, which allows to ensure the ability (efficiency) of banking system, is within 5-6 % to GDP. The made analyze of the level of banking system of Ukraine capitalization during the period 2005-2010, the result of which is given in the table 3, proves (demonstrates) that according to this criterion the banking sector capitalization exceeded the minimum level and continue to increase it. The growth of correlation of regulatory capital to GDP was stipulated by following factors:

- mass inflow of the foreign banking capital in Ukraine with the international requirements (demands) to the level of capitalization;
- active increase (accumulation) of capital by Ukrainian banks, which did not have external recourses;
- forecasting of credit expansion in further years [4].

Rather high profitability of banking business in Ukraine became one of the main reasons of impetuous penetration of foreign capital on national banking market, which is necessary to admit as the most important tendency of last years in the dynamic development of modern banking system of Ukraine. It is one of the reflections of the economic processes globalization, which has positive aspects as well as negative ones.

Table 2. Macroeconomic indicators of capitalization level of banking system of Ukraine in 2005-2010 pp. [3]

Index	Year					
	2005	2006	2007	2008	2009	2010
GDP, mln. UAH.	441 452	544 153	720 731	949 864	914 732	1085 927
Regulatory capital of banking system	mln. UAH.	26 373	41 148	72 265	123 066	135 802
	% to GDP	5,97	7,56	10,03	12,96	14,8
Adequacy of regulatory capital (H2), %		14,95	14,19	13,92	14,01	18,08
						20,83

The inflow of foreign capital in the banking system of Ukraine began from the middle of 90th years of XX century. But the active development of this process was observed from 2005. The increase of specific weight of banks with foreign capital in Ukraine enhanced the competitiveness in banking sector, increased the banking system capitalization, made national banks to reduce the unproductive expenses, and improved the level of corporative management in the banking sector [6].

During 2008-2009 the number of operating banks with foreign capital decreased from 53 to 51 bank, or from 28,8 % to 28,0 % of the total number of operating banks. The number of banks created with 100% foreign capital increased during the year by 1 to 18 banks (Table 4). At the same time it should be mentioned that the expected growth of price competitiveness in consequence with considerable inflow of foreign capital, which is associated with inexpensive and long-term financial recourses, in the national banking system did not occur. The foreign financial groups, working on the market of Ukraine, do not sink down interest rates, as long as there is no sense to decrease their own profits. More over taking into account that the spread of foreign banks in Ukraine occurred through buying of local banks and high interest rates give an opportunity to return investments in short period [1].

The main countries of foreign capital origin in banking system of Ukraine are, first of all, the Russian Federation, France, Cyprus which in 2009 held consequently first, second and third position.

Table 4. The indexes of foreign capital presence in banking system of Ukraine [1]

Index	Year				
	2005	2006	2007	2008	2009
Quantity of operating banks	165	170	175	178	182
Including with the share of foreign capital	23	35	47	53	51
Among them with 100 % foreign capital	9	13	17	17	18
Specific weight of foreign capital in banks core capital, %	19,5	27,6	35,0	41,1	34,6



As for the Russian Federation, it is necessary to emphasize that in 2009 compared with 2008 its specific weight increased from 5,45 % to 8,13%. Besides, the capital of following countries as Kazakhstan, Ireland, United Kingdom, Luxembourg, the USA, Georgia, Turkey, Canada, Switzerland, Virgin Islands, Latvia, Finland, Iceland, Bahamas, Slovakia, Cayman Islands, Lithuania and Slovenia is represented in the banking system of Ukraine [2].

Despite improvements in the banking sphere, today significant problems that prevent the successful functioning of the banking system of Ukraine are remained. Is necessary to note main of them: low competitiveness of the banking sector, ie the impossibility of domestic banks compete with foreign, low quality services for their high cost; the debt of borrowers to banks, expensive and ineffective state support of troubled banks, low bank capitalization of banks. With the purpose of improvement of the banking institutions in Ukraine it is necessary to do some arrangements, in particular:

1. to enhance the capitalization of the banking system. Condition and resource capabilities of the banking system of Ukraine significantly affect on the economic development of the country. Therefore the increasing of bank capital and improvement of its structure has particular importance;
2. to provide disclosure of banking information by creating a system of independent rating agencies and credit bureaus;
3. to increase the prudential supervision of banking institutions, including risk management;
4. to improve the mechanism for recovery of troubled banks and bank liquidation procedures;
5. to develop the structure of the banking sector towards the optimal combination of large banks with extensive branch network of regional and specialized banks with the purpose to approach full-fledged banking services to the people;
6. to develop and implement policies of banking risks management, including the establishment of the possible types of risks for macroeconomic and financial stability and determination of measures for their control.

**Conclusion.** To sum it up it is necessary to say that the current economic situation require stabilization of the banking system as a key condition for

economic recovery in Ukraine, support of the liquidity and solvency of Ukrainian banks, improvement of the liquidity management of banks, improvement of the efficiency of liquidity ratios, implementing of comprehensive reform of the banking sector.

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